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Supreme Court, U.S.
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No. _____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

CHARLES T. GREEN AND KAY E. GREEN, ET AL.,
Petitioners,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

Whether the statute of limitations with respect to items appearing on a Form 1120S income tax return of a Subchapter S corporation is to be applied at the corporate level as we contend and as was decided by the United States Court of Appeals for the Ninth Circuit in *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989), or whether the statute of limitations with respect to items appearing on a Form 1120S income tax return of a Subchapter S corporation is to be applied at the shareholder level as was held in *Bufferd v. Commissioner*, 952 F.2d 675 (2d Cir.), *cert granted*, ____U.S.____, 112 S. Ct. 2990 (1992) (No. 91-7804), *Fehlhaber v. Commissioner*, 954 F.2d 653 (11th Cir. 1992), and *Green v. Commissioner*, 963 F.2d 783 (5th Cir. 1992) (the captioned case in the court below).

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OCTOBER TERM, 1992

CHARLES T. GREEN AND KAY E. GREEN, ET AL.,
Petitioners,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Petitioners Charles T. Green and Kay E. Green, et al.,[1] respectfully pray that a writ of certiorari issue to review

1. In addition to Mr. and Mrs. Green, Petitioners include Robert White and Jean R. White (Nos. 90-4630 and 90-4631), Gene C. Elkins and Louise Elkins (No. 90-4632), R. Talley Melton and Carolyn Melton (No. 90-4847), Bobby L. Davis and Ramona A. Davis (No. 90-4849), James R. Graves and Elizabeth J. Graves (No. 90-4850), Don C. Quast and Audrey N. Quast (No. 90-4851), Elizabeth C. Mayfield (No. 90-4852), Jack E. Blanco and Jeanne Blanco (No. 90-4853), and Martin Brody and Jerrilyn Brody (No. 91-4497). Norman C. Way and Mary K. Way (No. 90-4848) and Mike Kane and Sandra Ann Kane (No. 90-4881), who were parties in the *Green* case in the Fifth Circuit, are not included

the judgment and opinion of the United States Court of Appeals for the Fifth Circuit, entered in the above-entitled proceeding on June 22, 1992.

OPINIONS BELOW

The opinion of the Court of Appeals for the Fifth Circuit is reported at 963 F.2d 783 (5th Cir. 1992), and is reprinted in Appendix A hereto, p.1a, *infra*.

The opinion of the United States Tax Court is reported at T.C. Memo 1991-78, and is reprinted in Appendix D hereto, p.24a, *infra*.

JURISDICTION

Petitioners brought an action in the United States Tax Court for the redetermination of the deficiencies proposed by Respondent. The Tax Court entered its decision the lead case in the Tax Court, that of Martin Brody and Jerrilyn Brody (No. 91-4497), in favor of Respondent on January 3, 1991.

After consolidation with substantially identical cases, the Court of Appeals for the Fifth Circuit affirmed the Tax Court's decision on June 22, 1992, under the name of *Green v. Commissioner*. No petition for rehearing was sought.

The jurisdiction of this Court to review the judgment of the Fifth Circuit is invoked under 28 U.S.C. Section 1254(1).

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herein as Petitioners. By stipulation in the United States Tax Court, the decisions in ten additional cases were not appealed to the Fifth Circuit but are tied to the outcome of the *Brody* case (No. 91-4497).

STATUTES INVOLVED

Internal Revenue Code of 1954[2]

SEC. 6012. PERSONS REQUIRED TO MAKE RETURNS OF INCOME.

(a) GENERAL RULE. -- Returns with respect to income taxes under subtitle A shall be made by the following:

* * *

(2) Every corporation subject to taxation under subtitle A;

* * * *

SEC. 6037 RETURN OF ELECTING SMALL BUSINESS CORPORATION

Every electing small business corporation (as defined in section 1371(b)) shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, the names and addresses of all persons owning stock in the corporation at any time during the taxable year, the number of share of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information,

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2. Because the taxable year in question was prior to the enactment of the Internal Revenue Code of 1986, all non-jurisdictional references are to the Internal Revenue Code of 1954, as amended and effective for the years at issue ("Code").

for the purpose of carrying out the provisions of subchapter S of chapter 1, as the Secretary may by forms and regulations prescribe. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012.

SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.

(a) General rule. -- Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on the or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

* * * *

STATEMENT OF THE CASE

All the facts of this case were stipulated by the parties and are contained in Appendix F p.34a and G p.40a. Petitioners were minority shareholders in electing small business corporations (until 1983, referred to as "Subchapter S corporations"). These shareholders claimed deductions on their Forms 1040 for their pro rata share of losses reported by the Subchapter S corporations in 1977, 1978 and 1979. At the request of the Internal Revenue Service ("IRS"), each of Petitioners signed extensions of the three-year statute of limitations on assessment of additional tax for those years; no

such extensions were signed by the Subchapter S corporations whose losses were reported on the individual tax returns of Petitioners.

By Notice of Deficiency dated December 18, 1986, Respondent disallowed Petitioners Martin and Jerrilyn Brody's claimed 1977, 1978 and 1979 losses attributable to the Subchapter S corporation for its taxable periods 1977, 1978 and 1979.

Petitioners then invoked the jurisdiction of the United States Tax Court under Sections 6213(a) and 6214(a) of the Internal Revenue Code of 1986, as amended, challenging the Notice of Deficiency. Petitioners Martin and Jerrilyn Brody's case was tried on fully stipulated facts which presented only one issue of law to the Tax Court: whether that court would adhere to its decision in *Kelley v. Commissioner*, T.C. Memo 1986-405, in light of the reversal of that decision by the Ninth Circuit Court of Appeals. 877 F.2d 756 (1989). The Tax Court refused to follow the Ninth Circuit (*Brody v. Commissioner*, T.C. Memo 1991-78).

Petitioners appealed to the United States Court of Appeals for the Fifth Circuit pursuant to Sections 7482(a)(1) and (b)(1)(A) of the Internal Revenue Code of 1986, as amended. In Consolidated Docket No. 90-4629, 963 F.2d 783 (5th Cir. 1992), the Fifth Circuit declined to follow the *Kelley* decision of the Ninth Circuit, holding instead that the three-year statute of limitations applicable to assessments of additional income tax attributable to a shareholder's investment in a Subchapter S corporation is the three-year statute of limitations pertaining to the individual's return, not the return of the Subchapter S corporation. The Fifth Circuit entered its decision in favor of Respondent on June 22, 1992. No petition for rehearing was filed in the Fifth Circuit Court of Appeals.

On the same day that the Fifth Circuit issued its opinion, this Court granted certiorari with respect to the Second Circuit's identical conclusion as to this statute of limitations question. *Bufferd v. Commissioner*, 952 F.2d 675 (2d Cir.), *cert. granted*, __ U.S.__, 112 S. Ct. 2990 (1992)(No. 91-7804).

REASONS FOR GRANTING THE WRIT

I.

This Court granted the writ of certiorari in *Bufferd* on the identical Subchapter S issue presented in this case. However, our facts present a "cleaner" fact situation on which to decide this issue. *Bufferd* contained an additional issue which should have precluded the Second Circuit from deciding *Bufferd* on the Subchapter S corporation issue. Our case does not contain this issue.

The taxpayer in *Bufferd* executed an extension of the statute of limitations that was limited to adjustments to distributive shares in "any partnership (or any organization treated by the taxpayer as a partnership on the taxpayer's tax return)." 952 F.2d at 678. Such a limited extension of the statute of limitations should not encompass the net operating loss reported on Bufferd's return attributable to his ownership of a Subchapter S corporation. *See, e.g., Armco, Inc. v. Commissioner*, 88 T.C. 946 (1987); *Bauer v. Commissioner*, T.C. Memo 1992-257; *Russello v. Commissioner*, T.C. Memo 1989-391. In effect, Bufferd's extension of the statute of limitations did not apply to Subchapter S corporate items, causing the statute of limitations to expire as to any assessments of items

attributable to a Subchapter S corporation. As a result, the Commissioner was barred from making any Subchapter S corporation-related adjustments to Bufferd's return. The Second Circuit did not hold the extension pertaining to the Subchapter S corporation items invalid, as it should have, and instead decided *Bufferd* on the Subchapter S issue. The captioned case presents a better opportunity to resolve the Subchapter S statute of limitations issue because it does not contain the *Bufferd* invalid extension problem.

II.

The Fifth Circuit's holding that separate waivers of the statute of limitations are not required for both a Subchapter S corporation and its shareholders is in conflict with the decisions of other Circuits and subverts the separate-entity doctrine of *Moline Properties*.

The United States Courts of Appeal have rendered conflicting decisions on the Subchapter S statute of limitations issue. The Fifth (in the instant case), Eleventh (*Fehlhaber v. Commissioner*, 954 F. 2d 653 (1992)) and Second (in *Bufferd*, in which certiorari has been granted) Circuits have held that separate waivers of the statute of limitations are not required for both a Subchapter S corporation and its shareholders.

In conflict with these decisions is *Kelley v. Commissioner*, T.C. Memo 1986-405, *rev'd*, 877 F.2d 756 (9th Cir. 1989). In *Kelley*, the Ninth Circuit reversed the Tax Court's decision and held that "the IRS may not adjust a shareholder's return based on an adjustment to an S corporation's return when the statute of limitations has run on the S corporation's return." 877 F.2d at 759.

The Eighth Circuit cited the *Kelley* decision in *Fendell v. Commissioner*, 906 F.2d 362 (8th Cir. 1990), and held that no adjustments could be made to a trust beneficiary's return based on trust losses at a time when the statute of limitations precluded adjustments to the trust's return. In addition, the Eighth Circuit cited *Illinois Masonic Home v. Commissioner*, 93 T.C. 145 (1989), and *Boatmen's First Nat'l Bank v. United States*, 705 F. Supp. 1407 (W.D. Mo. 1988). Each of these cases embodies the principle that in order for the Commissioner to adjust tax liability, he must be able to do so at the source of the income, or else he will be prevented from doing so at the point where the income is distributed. Since Subchapter S corporation shareholders and the Subchapter S corporation, like beneficiaries and the trust, are separate taxable entities, no adjustments on the shareholders' individual returns can be made with respect to S corporation items if the Subchapter S corporation's limitations period has expired.

In addition to creating a conflict with other Circuits, the decision below subverts the separate-entity doctrine of *Moline Properties*. As stated by this Court in *Moline Properties, Inc. v. Commissioner*, 319 U.S. 436, 438-439 (1943):

> The doctrine of corporate entity fills a useful purpose in business life. . . . [S]o long as that purpose is the equivalent of business activity or is followed by the carrying on of business by the corporation, the corporation remains a separate taxable entity.

However, despite this Court's recently expressed concern "that the separate-entity doctrine of *Moline* not be subverted," *Commissioner v. Bollinger*, 485 U.S. 340 (1988), the decision below, in fact, disregards the Subchapter

S corporation's existence as distinct from that of its shareholders.

Section 6037 of the Code requires a Subchapter S corporation to file a return. The Section goes on to say that the return will be considered a corporate return when determining the applicable statute of limitations on additional tax assessments.

Section 6012(a)(2) of the Code also requires every corporation subject to income taxes under Subtitle A to file a return. Reading Section 6012(a)(2) in conjunction with Section 6037, the return filed by a Subchapter S corporation must be treated as an income tax return of the corporation for the purpose of establishing the appropriate statute of limitations period.

Section 6501(a) of the Code contains the statute of limitations rule for IRS audit and assessment of a tax on a corporate return. It states in pertinent part: "Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed. . . ." By holding that a Subchapter S corporation's shareholder's tax return is the relevant return with regard to items that appear on the Subchapter S corporation's income tax return, the Fifth Circuit disregards the Subchapter S corporation's income tax return. The conflict between *Moline Properties* and the instant case is thus apparent and deserves this Court's attention.

The Fifth Circuit has created a precedent which conflicts with decisions of this Court and other circuits and is likely to create further litigation and confusion in Circuits yet to resolve this issue.

III.

The decision below -- that an IRS audit adjustment made to a Subchapter S corporation's return after the statute of limitations has run can form the basis for an IRS audit adjustment to the Subchapter S corporation's shareholders' returns -- raises important and unresolved problems which are likely to generate further litigation.

The *Kelley* decision is predicated largely on the concept of finality. As the *Kelley* court stated, "the statute of limitations exists in part so that after some time persons can be confident that their affairs are closed and that they can dispose of old records." *Kelley*, 877 F.2d at 758. If a shareholder cannot be confident that the statute of limitations has run on the Subchapter S corporation's income tax return, the shareholder cannot be confident that his individual return is final for that particular year with respect to Subchapter S corporation items. Such a result negates the concept of finality because shareholders would not know when "their affairs are closed." *Kelley*, 877 F.2d at 758.

The IRS is also entitled to finality. If the precedent set below is allowed to stand, it could impact on the IRS's ability to collect revenue. If, for example a Subchapter S corporation sought to amend its income tax return to reduce reported income or increase its loss after three years from filing its return, the IRS could not bar the amendment's effect on shareholders because the limitations period had run for the corporation. As long as a shareholder's return remains open, an individual shareholder, like each of Petitioners, could amend his individual return to reduce income or claim increased losses despite the IRS's inability

to examine the Subchapter S corporation's income tax return. Although this result is absurd, it is a logical outcome of the decision in the case below.

Finally, Petitioners note the existence of other litigation involving this issue. Summary judgment on this issue was entered in *Aries v. Commissioner*, T.C. Memo 1991-41, *interlocutory appeal denied*, No. 3827-89, 3841-89 (Tax Court, May 22, 1991).

Lower courts thus need guidance from this Court on the question of whether an adjustment made to a Subchapter S corporation's return, after the statute of limitations has run, can form the basis for an adjustment to the Subchapter S corporation's shareholders' returns.

CONCLUSION

For the reasons stated above, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX A
United States Court of Appeals, Fifth Circuit Opinion

CORRECTED GREEN v. C.I.R. 5150

Charles T. GREEN and Kay E. Green,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Bobby L. and Ramona A. DAVIS,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Robert WHITE and Jean R. White,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

James R. and Elizabeth J. GRAVES,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Robert WHITE and Jean R. White,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Don C. and Audrey N. QUAST,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Gene C. ELKINS and Louise Elkins,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Elizabeth C. MAYFIELD,
Petitioner-Appellant,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

R. Talley and Carolyn MELTON,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Jack E. and Jeanne BLANCO,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Norman C. WAY and Mary K. Way,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Mike and Sandra Ann KANE,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Martin BRODY and Jerrilyn Brody,
Petitioners-Appellants,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

Nos. 90-4629 to 90-4632, 90-4847 to 90-4853, 90-4881 and 91-4497.

United States Court of Appeals,
Fifth Circuit.

June 22, 1992.

Commissioner of Internal Revenue sought to assess deficiency against shareholders of S corporation within three years after shareholder filed its return but more than three years after S corporation filed its return. The United States Tax Court held that statute of limitations did not bar

assessment. Taxpayers appealed. The Court of Appeals, Goldberg, Circuit Judge, held that: (1) limitations period began when shareholders filed their personal income tax returns, and (2) notice of assessment was timely when made within period consented to by taxpayers.

Affirmed.

1. Internal Revenue 4706

Court of Appeals engages in de novo review of tax court's conclusion of law.

2. Internal Revenue 4568

Three-year period of limitations applies for assessing any tax imposed under Internal Revenue Code. 26 U.S.C.A. § 6501(a).

3. Internal Revenue 4575

Taxpayer and Commissioner of Internal Revenue can contract to extend three-year statute of limitations period for assessing tax imposed under Internal Revenue Code. 26 U.S.C.A. § 6501(a, c).

4. Internal Revenue 4570

Three-year statute of limitations for assessing tax liability against shareholder of Subchapter S corporation begins to run from date that individual files tax return, and not date that S corporation files its return. 26 U.S.C.A. § 6501(a, c).

5. Internal Revenue 4546

Notice of deficiency in income tax against shareholders of S corporation was timely, even though sent more than three years after S corporations filed returns, where notice was issued within period of taxpayers' consent to extension of period for Commissioner of Internal Revenue to assess tax due on taxpayers' tax returns. 26 U.S.C.A. § 6501(a, c).

6. Internal Revenue 4574

Expiration of period of limitations as to Subchapter S corporations does not preclude Commissioner of Internal Revenue from assessing deficiencies attributable to disallowance of losses passed through from S corporations to shareholders. 26 U.S.C.A. § 6501(a, c).

7. Internal Revenue 4568

Section of Internal Revenue Code requiring Subchapter S corporations to file information returns, and that such filing be treated for limitations purposes as return under statute requiring corporations subject to tax to file returns provides limitations period for organizations that file returns as S corporations but are nonetheless required to pay some tax on organization's income; section does not apply to assessments against shareholders. 26 U.S.C.A. § 6037.

Appeals from the United States Tax Court.

Before GOLDBERG, DUHE, and BARKSDALE, Circuit Judges.

GOLDBERG, Circuit Judge:

The statute of limitations in section 6501 of the Internal Revenue Code declares that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed." 26 U.S.C. § 6501(a).[1] A Subchapter S corporation makes a return for a taxable year and, more than three years after the S corporation files its return, the Commissioner of Internal Revenue seeks to assess a deficiency against a shareholder of that S corporation for certain losses passed through from the S corporation to the shareholder, within three years after the shareholder filed its return. Must the Commissioner act within three years from the filing of *both* the shareholder's individual income tax return and the return of the Subchapter S corporation, or can the Commissioner determine the shareholder's tax liability within three years from the filing of the shareholder's return? We hold that the statute of limitations must be open only as to the individual taxpayer for the Commissioner to adjust the shareholder's tax liability based on the disallowance of losses passed through to the shareholder from the S corporation.

I. BACKGROUND

Martin and Jerrilyn Brody owned ten percent of the stock of a qualified, duly electing Subchapter S corporation called Delta Selectune, Inc. during the taxable years 1977, 1978 and 1979. The Brodys also owned ten percent of the stock of another qualified, duly electing Subchapter S corporation called St. Louis Selectune, Inc. during the taxable years 1978 and 1979. The Delta and St. Louis Selectune Subchapter S corporations engaged in the business of selling cassette and eight-track audiotapes of music selected by customers from compositions in the record

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[1] Unless otherwise indicated, all citations to the Internal Revenue Code refer to the Internal Revenue Code as amended and effective during the years involved in this appeal.

library of Franklin Industries, Inc. The Brodys limited their participation in the corporations to these passive investments. The Brodys did not know the names of the other shareholders or the names of the directors of the two S corporations.

Delta reported losses on its return for its taxable year 1977, while both of the Subchapter S corporations reported losses on their returns for their taxable years 1978 and 1979. The Brodys, as shareholders of the Subchapter S corporations, claimed deductions of their *pro rata* share of these losses on their individual income tax returns for the years 1977, 1978 and 1979. Both Delta and St. Louis ceased operations and closed their offices in 1981.

Complying with a request by the Internal Revenue Service, the Brodys entered into written agreements with the Service extending the statutes of limitations for assessing tax against them for the years 1977, 1978 and 1979 indefinitely. Neither of the S corporations agreed to extend the statute of limitations for any of the taxable years involved in this case. The Commissioner of Internal Revenue subsequently determined deficiencies in income tax against the Brodys for the taxable years 1977, 1978 and 1979, disallowing the deductions of the Brody's *pro rata* share of the losses incurred by the Subchapter S corporations. In December of 1986, before the extended statute of limitations for the Brodys expired, but after the statutes of limitations for the S corporations expired, the Commissioner issued a notice of deficiency to the Brodys for these years.

[1] The Brodys petitioned the United States Tax Court for a redetermination of the deficiencies determined by the Commissioner. The tax court tried the case on stipulated facts, deciding an issue of law: whether the expiration of the statute of limitations as to a Subchapter S corporation barred the assessment of deficiencies against individual taxpayers

attributable to the disallowance of losses claimed by the taxpayers as shareholders in the Subchapter S corporations. *Brody v. Commissioner*, 61 T.C.M. (CCH) 1993, 1994 (1991). The tax court followed its decision in *Fehlhaber v. Commissioner*, 94 T.C. 863 (1990)(reviewed by the tax court), *aff'd* 954 F.2d 653 (11th Cir. 1992), and held that since the statute of limitations did not bar the assessment, the Commissioner timely issued the notice of deficiency. *Brody*, 61 T.C.M. at 1995. In reaching this decision, the tax court rejected the reasoning of the Ninth Circuit in *Kelley v. Commissioner*, 877 F.2d 756 (9th Cir. 1989). The taxpayers appeal, arguing that the statute of limitations must be open as to both the individual taxpayer and the Subchapter S corporation and urging this Court to embrace the reasoning of the Ninth Circuit as articulated in *Kelley*.[2] We engage in a *de novo* review of the tax court's conclusion of law. *Texas Learning Technology Group v. Commissioner*, 958 F.2d 122, 124 (5th Cir. 1992)(citations omitted). We choose to follow the persuasive reasoning of the Eleventh Circuit in *Fehlhaber* and the Second Circuit in *Bufferd* and thus affirm the tax court.[3]

II. DISCUSSION

A truncated description of how Subchapter S corporations operate under the Internal Revenue Code helps clarify the facts of this case. Congress adopted Subchapter

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[2] Although this Court did reference the *Kelley* opinion in an unpublished decision, *Tom Brown, Inc. v. United States*, 883 F.2d 71 (5th Cir. 1989), we expressly stated that "we need not and do not now pass on the precise issue presented in *Kelley*." Today we confront the issue decided in the *Kelley* case for the first time.

[3] We do not reach the second issue presented by the Appellants concerning certain of the taxpayers' motions to vacate because we decide the statute of limitations issue in favor of the Commissioner.

S in 1958. Subchapter S generally exempts an "electing small business corporation" from all corporate income taxes. William M. Richardson & Samuel P. Starr, *Task Force Report on Taxable and Tax-Free Acquisitions Involving S Corporations*, 45 Tax Law. 435, 437 (1992). A Subchapter S corporation, then, unlike a Subchapter C corporation, usually does not pay taxes. Rather, Subchapter S of the Internal Revenue Code treats the S corporation as a "'pass through' entity under which income and losses flow directly to the shareholders." *Fehlhaber*, 954 F.2d at 654 & n. 2 (citation omitted). The S corporation files an information return, which reports the corporation's gross income, deductions, the names and addresses of its shareholders, distributions to the shareholders, and the shareholders' *pro rata* share of each item of the corporation for the taxable year. *Id.* at 654 & n. 3 (citing Treas.Reg. § 1.6037-1(a) (1959)). It is the shareholders who include their distributive "share of the S corporation's income, gain, losses, deductions, and credits on their own personal returns.". *Id.* at 654 & n. 4 (citation omitted).

[2] In our interpretation of the Internal Revenue Code, we "adhere to the plain language of the law unless 'literal application of [the] statute will produce a result demonstrably at odds with the intentions of its drafters." *Federal Deposit Ins. Corp. v. Meyerland Co. (In re Meyerland Co.)*, 960 F.2d 512, 516 (5th Cir.1992) (en banc) (quoting *Griffin v. Oceanic Contractors, Inc.*, 450 U.S. 564, 102 S.Ct. 3245, 3250, 73 L.Ed.2d 973 (1982)). Section 6501(a) of the Internal Revenue Code provides that "the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed." 26 U.S.C. § 6501(a). The plain language of section 6501 thus establishes a three year period of limitations "for assessing any tax imposed under the Code." *Fehlhaber*, 954 F.2d at 654.

[3] The taxpayer and the Commissioner can, however, contract to extend the three-year statute of limitations period. An exception to the limitations period arises when the Commissioner and the taxpayer consent in writing--before the three-year period expires--to an extension of time for the assessment of tax. 26 U.S.C. § 6501(c). The Brodys executed a "Special Consent to Extend the Time to Assess Tax" for the taxable years 1977, 1978 and 1979. These Consents permitted the Commissioner to assess the income tax due on the return for a particular year until the agreement ended. Each agreement, by its terms, continued in effect until ninety days after revocation of the Consent by the Brodys. The extension of the period of limitations does not alter our discussion: it works no change in our analysis whether the Commissioner asserted the deficiency either within three years after the Brodys filed a particular return or, as here, within the time allowed under the extension for that taxable year. The parties do not dispute that the Commissioner issued the notice of deficiency for the taxable years 1977, 1978 and 1979 *before* the agreements extending the time to assess the income tax due on the returns for those years terminated. Our inquiry remains the same: Does the filing of the taxpayer return or the Subchapter S return commence the running of the statute of limitations?

[4] Section 6501(a), the focus of our statutory analysis, is quite simple, yet curiously inexplicit. Section 6501(a) mandates that any tax imposed under the Internal Revenue Code must be assessed within three years after "*the return* was filed." The issue in this case reduces to the conspicuous question: Three years after *which* return was filed? Although the plain language of the provision establishes a three year limitations period, Congress neglected to specify whether--when the Commissioner attempts to assess a deficiency against that taxpayer for adjustments to the taxpayer's distributive share of items passed through from the S

corporation--the period begins when the S corporation files its return or when the shareholder files his or her personal income tax return. *See Kelley*, 877 F.2d at 759 (Section 6501 "does not indicate whether the relevant return is the taxpayer's or the corporation's.").

[5] The Brodys argue that the statutory period for assessing deficiencies in income tax from the shareholders of an S corporation that relate to adjustments in items passed through from a Subchapter S corporation commences when the S corporation files its return. Since the S corporations filed their returns in 1978, 1979 and 1980, the Brodys claim that the three-year statute of limitations expired "long before the Commissioner sent the 1986 notice of deficiency" to them. The Commissioner contends that the deficiencies were asserted within the period of limitations because it is the taxpayer's return, not the Subchapter S corporation's return, that triggers the running of the period of limitations. And, because the Commissioner asserted the deficiencies within the period allowed under the extensions signed by the Brodys, section 6501 does not bar the assessment. We agree with the Commissioner.

In agreeing with the Commissioner, we find ourselves in accord with the Eleventh Circuit, *Fehlhaber*, 954 F.2d at 655, and the Second Circuit, *Bufferd v. Commissioner*, 952 F.2d 675, 677 (2nd Cir. 1992), *petition for cert. filed*, __ U.S.L.W. __ (U.S. Mar. 31, 1992)(No. 91-4099). We are persuaded by the Eleventh Circuit's emphasis on the nature of the return filed by the Subchapter S corporation in interpreting the meaning of section 6501(a). As explained above, the S corporation ordinarily pays no corporate income tax; rather, "its income is taxed directly to its shareholders under personal income tax rates." *Fehlhaber*, 954 F.2d at 655 (citation omitted). The return of the S corporation contains information about the corporation, including its

gross income and deductions, and its shareholders, including the names and addresses of its shareholders, distributions to the shareholders, and the shareholder's *pro rata* share of each item of the corporation for the taxable year. *Id.* at 654 & n. 3; *see* 26 U.S.C. § 6037. The return of the S corporation typically does not reflect any corporate tax liability, so the return filed by the Subchapter S "is merely an *informational* return." *Fehlhaber*, 954 F.2d at 655 (emphasis added). Each shareholder reports her *pro rata* share of these S corporation items, using this information to assist in calculating her federal income tax on her individual income tax return. The information relayed by the S corporation's return about its shareholders falls far short of that needed to compute an individual shareholder's tax liability. *Id.* The Subchapter S corporation's return obviously does not reveal each shareholder's adjusted basis in the corporate stock, "nor does it show [the shareholder's] income, losses, deductions, and credits from other sources." *Fehlhaber*, 94 T.C. at 869. For these reasons, the information return filed by the S corporation cannot support the assessment of a tax against the *entity*, for "the corporation itself is ordinarily not subject to any tax," or the *shareholder*, for "the return lacks sufficient information to determine the individual's tax liability." *Fehlhaber*, 954 F.2d at 655.

When Congress revised Subchapter S in 1982, it described the provisions in effect at the time.[4] The Senate Report explained that

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[4] The 1982 amendments to Subchapter S concerning the tax treatment of subchapter S items do not apply to the 1977, 1978 or 1979 taxable years involved in this appeal. *See* 26 U.S.C. §§ 6241-6245 (West 1989).

> [u]nder present law, a taxpayer's individual tax liability is determined in proceedings between the Internal Revenue Service and the individual whose tax liability is in dispute. Thus, any issues involving the income or deductions of a subchapter S corporation are determined separately in administrative or judicial proceedings involving the individual shareholder whose tax liability is affected. Statutes of limitations apply at the individual level, based on the returns filed by the individual. *The filing by the corporation of its return does not affect the statute of limitations applicable to the shareholders.*

S.Rep. No. 640, 97th Cong., 2d Sess. 25 (1982), *reprinted in* 1982 U.S.C.C.A.N. 3253, 3275 (emphasis added). We agree with the Eleventh Circuit that this legislative history, although not contemporaneous, supports the conclusion that "the limitations period for assessing a tax liability against a shareholder begins to run from the date that the *individual*, and not the S corporation, files his return." *Fehlhaber*, 954 F.2d at 657 (emphasis added); *see Bufferd*, 952 F.2d at 678 ("[T]he relevant return for determining the statute of limitations is the return of the taxpayer against whom the tax is sought."). *But see Kelley*, 877 F.2d at 759 ("[T]he IRS may not adjust a shareholder's return based on an adjustment to an S corporation's return when the statute of limitations has run on the S corporation's return.").

[6] The expiration of the period of limitations as to the Subchapter S corporations does not preclude the Commissioner from assessing deficiencies attributable to the disallowance of losses passed through from the S corporations to the shareholders. The statute of limitations applicable to the shareholders commences at the time the shareholders file their individual income tax returns. The Commissioner has three years, or, as in this case, an

extended period of time pursuant to agreements between the shareholder and the Commissioner, to assess a tax upon the shareholder for S corporation-related items. The Consents signed by the Brodys granted the Commissioner the power to assess tax due on the Brody's 1977, 1978 and 1979 tax returns at the time the Commissioner issued the notice of deficiency. We hold that the Commissioner issued the notice of deficiency within the period of limitations.

The Brodys advance several arguments that militate against commencing the statute of limitations at the time the shareholders file their returns. First, the Brodys contend that our holding promotes unfairness. The Ninth Circuit in *Kelley* expressed a similar concern. *See Kelley*, 877 F.2d at 758. When the IRS seeks to adjust a shareholder's return for items passed through from an S corporation more than three years after the filing of the S corporation's return, the shareholder opposing the adjustment can defend itself "only by resort to the corporation's books and records." *Id.* According to the Ninth Circuit, inimical repercussions would result from a rule construing the words of 6501(a) as referencing the shareholder's return: Either the corporation would bear an onerous obligation to maintain its books and records beyond three years after it files it information return or the shareholder would experience a diminished ability to defend against the adjustment because the corporation had demolished the relevant records. *Cf. id.*

This assertion does not sway our adherence to interpreting the statute of limitations as we do today. First, it is not unfamiliar in the world of tax to have "an individual's income tax return ... dependent on records maintained by another entity." *Fehlhaber*, 954 F.2d at 658 (citing partnership and trust taxation as examples). Second, the rule generally does not impose an undue burden on the corporation or the shareholder. S corporations, by

definition, have only a small number of shareholders. A shareholder can "take the necessary steps to ensure that the corporation preserves the relevant records." *Id.* Such protective steps simply do not constitute an overly oppressive task for the shareholder. *Bufferd*, 952 F.2d at 678. Even if we were to hold that the statute of limitations commenced with the filing of the Subchapter S return, we could issue no guarantee that the corporation would preserve its records until that period expired, just as we cannot assure the shareholder that the corporation will preserve the relevant books and records when the shareholder requests that it do so. In *either* event, the shareholder remains dependent on the corporation to retain the relevant records. We cannot alter this feature of the relationship between the Subchapter S corporation and its shareholders. In 1979, the management of one of the S corporations, Delta, alerted the Brodys to an audit of Delta's 1977 return. Two of the consents to extend the time to assess tax against the Brodys, executed in 1982 and 1983, limited any deficiency assessment to that resulting from, *inter alia*, any adjustment to the Brody's "distributive share of any item of income, gain, loss, deduction, or credit of" Delta and St. Louis. The Brodys do not argue that they took immediate action to ensure that the S corporations safeguarded the books and records needed to support the S corporation items on their individual returns when they learned of potential problems with the pass-through items. *See Bufferd*, 952 F.2d at 678 (citing *Siben v. Commissioner*, 930 F.2d 1034, 1037 (2nd Cir.), *cert. denied*, ---U.S.---, 112 S.Ct. 429, 116 L.Ed.2d 449 (1991)). Indeed, the Brodys did not attempt to locate the corporate records for the taxable years 1977, 1978, and 1979 until after receipt of the notice of deficiency in 1986. Finally, we reject any suggestion that we elevate the "perceived unfairness to taxpayers" over our duty to strictly construe in favor of the government a statute of limitation when the petitioner seeks application of the statute so as to bar the rights of the government. *Fehlhaber*,

954 F.2d at 658 (citing *Badaracco v. Commissioner*, 464 U.S. 386, 104 S.Ct. 756, 761, 78 L.Ed.2d 549 (1984)) (quoting *E.I. Du Pont De Nemours & Co. v. Davis*, 264 U.S. 456, 44 S.Ct. 364, 366, 68 L.Ed. 788 (1924)); *see Sage v. United States*, 908 F.2d 18, 24 (5th Cir. 1990).

[7] Second, the Brodys forcefully assert that section 6037 of the Internal Revenue Code answers the question posed by section 6501(a). Section 6037 requires that every S corporation file a return each taxable year. 26 U.S.C. § 6037. Furthermore, "[a]ny return filed pursuant to [section 6037] shall, for purposes of chapter 66 (relating to limitations), be treated as a return filed by the corporation under section 6012." *Id.* The Brodys claim that this language in section 6037 supplies a ready answer to the question raised by section 6501: Three years after which return was filed? The "return filed by the corporation."

The answer suggested by the taxpayers ignores one critical part of the final sentence of section 6037. If we treat "any return" filed pursuant to section 6037 as "a return filed by the corporation *under section 6012*" for period of limitations purposes, we must, of course, consult section 6012. Section 6012(a) simply requires that "every corporation *subject to taxation*" file a tax return. 26 U.S.C. § 6012(a)(emphasis added). We read the plain language of 6037 to mean that any information return filed by the Subchapter S corporation pursuant to section 6037 constitutes a tax return filed by the S corporation under section 6012 for limitations purposes--should the S corporation fall into the somewhat extraordinary position of owing tax itself. Both the Eleventh and Second Circuits extensively considered the effect of 6037 on the section 6501 issue. Both courts concluded, as we do, that "[s]ection 6037 provides the limitations period for organizations that file returns as S corporations but are nonetheless required to pay some tax on

the organization's income." *Bufferd*, 952 F.2d at 677. "[T]he last sentence in section 6037 does not apply to a subchapter S corporation unless its return establishes that the corporation owes a tax." *Fehlhaber*, 954 F.2d at 656.

Two examples surface in which a corporation that files a return pursuant to section 6037 pays tax directly, rather than merely functioning in its typical role as a pass-through entity. If an S corporation receives certain capital gains, the S corporation itself must pay tax on that income. *Bufferd*, 952 F.2d at 678; *Kelley*, 877 F.2d at 758. Moreover, if a corporation files an S corporation return, yet was not eligible for treatment as an S corporation, the filing of the return under 6037 triggers the three-year statute of limitations for assessing taxes on the corporation's income. *See Fehlhaber*, 954 F.2d at 656 n. 15 (citations omitted); *Kelley*, 877 F.2d at 758. The legislative history to section 6037 supports this reading of the section's last sentence:

> Notwithstanding the fact that an electing small-business corporation is not subject to the tax imposed by chapter 1 of the 1954 Code, such corporation must make a return for each taxable year in accordance with new section 6037.... Such return will be considered as a return filed under section 6012 for purposes of the provisions of chapter 66, relating to limitations. Thus, for example, the period of limitation on assessment and collection of any corporate tax found to be due upon a subsequent determination that the corporation was not entitled to the benefits of subchapter S, will run from the date of filing of the return required under the new section 6037.

S.Rep. No. 1983, 85th Cong., 2d Sess. 226 (1958), *reprinted in* 1958 U.S.C.C.A.N. 4791, 5014. *But see*

Kelley, 877 F.2d at 759 ("While [the Senate Report] refers to an unqualified corporation as an example, it leaves open whether the statute of limitations applies in other situations."). The parties do not dispute that the filing of the Subchapter S corporations' returns commenced the running of the statutes of limitations applicable to the assessment of any corporate tax. Nor do the parties assert that the returns filed by the S corporations for the taxable years involved in this appeal established that the Subchapter S corporations separately owed any tax for those years. The final sentence of 6037 simply does not apply to the facts of this case.

III. CONCLUSION

For the reasons explained above, we AFFIRM the judgments of the United States Tax Court.

A true copy
Test
Clerk, U.S. Court of Appeals, Fifth Circuit

By/s/ Rhonda Flowers
Deputy 9/2/92

New Orleans, Louisiana

APPENDIX B
United States Tax Court Notice of Appeal

TAX COURT FILED
JUN 10 1991

UNITED STATES TAX COURT

MARTIN BRODY and JERRILYN BRODY,	§	
Petitioners,	§	
	§	**Docket No. 963-87**
V.	§	**SELECTUNE**
COMMISSIONER OF INTERNAL REVENUE,	§	
Respondent.	§	

NOTICE OF APPEAL

Notice is hereby given that Petitioners Martin Brody and Jerrilyn Brody, hereby appeal to the United States Court of Appeals for the Fifth Circuit from the decision of this Court entered in the above-referenced proceeding on May 14, 1991.

DATED: June 7, 1991

/s/ Shelley Cashion
SHELLEY CASHION
Tax Court No. CS0293
Chamberlain, Hrdlicka, White Williams & Martin
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(713) 658-1818

OF COUNSEL:

**Chamberlain, Hrdlicka, White
Williams & Martin
1400 Citicorp Center
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Houston, Texas 77002
(713) 658-1818**

SERVED JUN 11 1991

CERTIFICATE OF SERVICE

IT IS HEREBY CERTIFIED that service of the foregoing Notice of Appeal has this 7th day of June, 1991, been made on counsel for Respondent by depositing a copy thereof, postage prepaid, in the United States mail, addressed to:

Janet Balboni, Esq.
Office of District Counsel
Internal Revenue Service
10850 Richmond, Suite 350
Houston, Texas 77042

Teresa Milton, Esq.
Department of Justice
Appellate Section
P.O. Box 502
Washington, D.C. 20044

/s/ Shelley Cashion
SHELLEY CASHION

SC194:83/lih
82-1020-00

APPENDIX C
United States Tax Court Decision

ORIGINAL

UNITED STATES TAX COURT

MARTIN BRODY and JERRILYN BRODY,	)	
Petitioners,	)	
	)	Docket No. 963-87
V.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	
Respondent.	)	

DECISION

Pursuant to the opinion of the Court filed February 27, 1991, and incorporating herein the facts recited in the respondent's computation as the findings of the Court it is

ORDERED AND DECIDED:

That there is a statutory deficiency in income tax due from the petitioners for the taxable year 1977, in the amount of $8,560.19 and that there is an overpayment in income tax due to the petitioners for the taxable year 1977 in the amount of $4,127.31, which amount was paid on October 1, 1986, and for which amount a claim for refund could have been filed under the provisions of I.R.C. § 6511(c) on December 18, 1986, the date of the mailing of the notice of deficiency.

That there is a statutory deficiency in income tax due from the petitioners for the taxable year 1978 in the amount of $26,795.10 and a deficiency to be paid in the amount of $10,766.79.

That there is a deficiency in income tax due from petitioners for the taxable year 1979 in the amount of $174.72.

That there are no additions to income taxes due from petitioners for the taxable years 1977, 1978 and 1979 under the provisions of I.R.C. § 6653(a).

That there are no additions to the income taxes due from petitioners for the taxable years 1977, 1978 and 1979 under the provisions of I.R.C. § 6621(c) (formerly I.R.C. § 6621(d)).

/s/ Arnold Raum
Judge.

Entered: May 14 1991

SERVED MAY 14 1991

It is hereby stipulated that the foregoing decision is in accordance with the opinion of the Court and the respondent's computation, and that the Court may enter this decision, without prejudice to the right of either party to contest the correctness of the decision entered herein.

/s/ Robert I. White
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5-9-91

APPENDIX D
United States Tax Court Memorandum Opinion

T.C. Memo. 1991-78

UNITED STATES TAX COURT

MARTIN AND JERRILYN BRODY, Petitioners v.
COMMISSIONER OF INTERNAL REVENUE, Respondent

Docket No. 963-87. Filed February 27, 1991.

Robert I. White, for the petitioners.

Janet R. Balboni, for the respondent.

MEMORANDUM OPINION

RAUM, Judge: The Commissioner determined deficiencies in income tax and additions to tax against Martin and Jerrilyn Brody (petitioners) for the taxable years 1977, 1978, and 1979, as follows:

Year	Amount	Section 6653(a)
1977	$26,738.00	$1,336.90
1978	36,161.40	1,807.57
1979	174.32	8.72

As part of the deficiency notice, the Commissioner also determined that petitioners are liable for the increased rate of

SERVED FEB 27 1991

interest provided by former section 6621(d) for their 1977 and 1978 taxable years. This section was amended and redesignated section 6621(c)[1] by section 1511(c)(1)(A) of Pub. L. 99-514, 100 Stat. 2085, 2744.

Petitioners were husband and wife when they filed the income tax returns for the taxable years at issue. They resided in Houston, Texas, at the time they filed the petition in this case. The case was submitted on the basis of a stipulation of facts and accompanying exhibits and a "second stipulation of facts," both filed on the same day. The sole issue is whether the period of limitations for assessing and collecting taxes had expired with respect to petitioners' 1977, 1978, and 1979 taxable years when the deficiency notice was sent to them.

During the taxable years 1977 through 1979, inclusive, petitioners owned ten percent of the stock of a qualified, duly electing subchapter S corporation called Delta Selectune, Inc. (Delta). During the taxable years 1978 and 1979, they also owned ten percent of the stock of another qualified, duly electing S corporation called St. Louis Selectune, Inc. (St. Louis). We will sometimes refer to Delta and St. Louis collectively as the "subchapter S corporations" or the "S corporations."

At the time petitioners made their investments in Delta and St. Louis, they did not contemplate having any active participation in the affairs of the corporations; rather, they purchased the stock solely as investments. During 1977, 1978, and 1979, petitioners had no participation in the affairs of either corporation other than as passive investors.

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[1] Except as otherwise indicated, all section references are to the Internal Revenue Code as emended and in affect for the taxable years at issue.

They did not know the names of the other shareholders or the names of the directors of the two corporations. By about 1981, the businesses of Delta and St. Louis had failed and their offices were closed.

In general, a subchapter S corporation is not required to pay tax on its income. Instead, each shareholder must report his pro rata share of the corporation's income and may deduct his pro rata share of its losses. See generally sections 1361-1379. In order to facilitate the administration of this "pass-through" system, a subchapter S corporation must file returns containing information about the corporation and its shareholders. Section 6037(a).[2]

Delta reported losses on its informational returns for its taxable years 1977, 1978, and 1979, which it filed on or about March 15, 1978, March 15, 1979, and March 15, 1980, respectively. St. Louis reported losses on its informational returns for its taxable years 1978 and 1979, which it filed on or about March 15, 1979 and March 15, 1980, respectively. Petitioners had nothing to do with the

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[2] **SEC. 6037. RETURN OF ELECTING SMALL BUSINESS CORPORATION.**

Every electing small business corporation (as defined in section 1371(b)) shall make a return for each taxable year, stating specifically the items of its gross income and the deductions allowable by subtitle A, the time during the taxable year, the number of shares of stock owned by each shareholder at all times during the taxable year, the amount of money and other property distributed by the corporation during the taxable year to each shareholder, the date of each such distribution, and such other information, for the purpose of carrying out the provisions of subchapterS of chapter 1, as the Secretary may by forms and regulations prescribe. Any return filed pursuant to this section shall, for purposes of chapter 66 (relating to limitations), be treated as a return by the corporation under section 6012.

preparation and filing of either the Delta or the St. Louis Forms 1120S for 1977, 1978, and 1979 returns. They claimed deductions for their pro rata share of these losses.

In June of 1981, August of 1982, and September of 1983, respondent asked petitioners to enter into written agreements extending the period of limitations with respect to their taxable years 1977, 1978, and 1979, respectively. Petitioners agreed to do so, and in response to each request, executed copies of Form 872-A ("Special Consent to Extend the Time to Assess Tax") covering the taxabie years for which the request was made. Under these agreements, the three-year period of limitations of section 6501(a)[3] pertaining to those taxable years was extended to the 90th day after the IRS office considering the case "receives Form 872-T, Notice of Termination of Special Consent to Extend the Time to Assess Tax, from the taxpayer(s)."[4] On

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[3] **SEC. 6501. LIMITATIONS ON ASSESSMENT AND COLLECTION.**

(a) General rule.--Except as otherwise provided in this section, the amount of any tax imposed by this title shall be assessed within 3 years after the return was filed (whether or not such return was filed on or after the date prescribed) or, if the tax is payable by stamp, at any time after such tax became due and before the expiration of 3 years after the date on which any part of such tax was paid, and no proceeding in court without assessment for the collection of such tax shall be begun after the expiration of such period.

[4] The stipulation and second stipulation appear to be in conflict as to whether petitioners terminated their consent to extend the period of limitations. The first stipulation states in paragraph 6 that "no notifications respecting terminations of the Forms 872A***were ever sent by either party." The second stipulation states in paragraph 7 that "in late September 1986, petitioners terminated the Forms 872A for 1977, 1978, and 1979 that they had signed." However, petitioners do not contend that the deficiency notice was untimely as to them, apart from their position relating to the expiration of the period of limitations in respect of the S corporations.

December 18, 1986, respondent issued the notice of deficiency, in which he disallowed petitioners' deduction of their pro rata share of the losses incurred by Delta in 1977, 1978, and 1979, and by St. Louis in 1978 and 1979.

Neither Delta nor St. Louis entered into agreements with the Commissioner to extend the period of limitations pertaining to any of the taxable years at issue. Under section 6037(a), an informational return filed by a subchapter S corporation "shall, for purposes of chapter 66 (relating to limitations) be treated as a return filed by the corporation under section 6012." And the corporate tax return required by section 6012(a)(2) triggers the running of the three-year period of limitations on the assessment and collection of tax. See section 6501(a). In this case, the three-year period with respect to Delta and St. Louis had expired by December 18, 1986, when the Commissioner sent petitioners the notice of deficiency. See section 6501(a). The issue in this case is whether the expiration of the period of limitations with respect to the subchapter S corporations prevents the Commissioner from assessing and collecting deficiencies that are attributable to the disallowance of losses claimed by petitioners as stockholders in those corporations.

We recently decided this issue in Fehlhaber v. Commissioner, 94 T.C. 863 (1990). There, we held without dissent in a Court-reviewed opinion that the informational return required of a subchapter S corporation by section 6037(a) did not start the running of the period of limitations with respect to its shareholders. In so holding, we rejected the reasoning of the Ninth Circuit in Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), revg. and remanding T.C. Memo. 1986-405, 52 T.C.M. 313, 55 P-H Memo par. 86,405 (1990). We have since followed Fehlhaber in Aries v. Commissioner, T.C. Memo. 1991-41 (filed February 5, 1991, slip op. p.5). And we have also

followed Fehlhaber in Siben v. Commissioner, T.C. Memo. 1990-435, 60 T.C.M. 524, 60 P-H Memo par. 90,435 (1990), where we held that the period of limitations for assessing a partner's tax must be determined at the level of the partner, not the partnership. Fehlhaber is controlling in this case. We hold that the period of limitations has not expired with respect to deficiencies, additions to tax, and increased interest that are attributable to the disallowance of losses passed through to petitioners from Delta and St. Louis in the taxable years at issue.

Due to the difference between the figures in the deficiency notice and those in the stipulation of the parties,

Decision will be entered under Rule 155.

APPENDIX E
United States Tax Court Stipulation of Settled Issues

ORIGINAL

UNITED STATES
TAX COURT
FILED
APR 5 1990

UNITED STATES TAX COURT

MARTIN BRODY and JERRILYN BRODY,	)	
Petitioners,	)	**Docket No. 963-87**
V.	)	
COMMISSIONER OF INTERNAL REVENUE,	)	**EK--SELECTUNE Judge Galloway**
Respondent.	)	

STIPULATION OF SETTLED ISSUES

The parties hereby stipulate that, for purposes of this case, issues have been resolved as follows:

1. In the Notice of Deficiency dated December 18, 1986, for the taxable year 1977, respondent increased petitioners income in the amount of $10,214.00 for Buckeye Development. Petitioners concede this issue.

2. There is one Selectune issue addressed in the Notice of Deficiency mailed to the petitioners on December 18, 1986, for the taxable year 1977. It is as follows:

2.a. Delta Selectune - disallowance of claimed subchapter S loss $59,000.00

3. There are two issues addressed in the Notice of Deficiency mailed to the petitioners on December 18, 1986, for the tax year 1978. They are as follows:

3.a. St. Louis Selectune - disallowance of claimed subchapter S loss $59,000.00

b. Delta Selectune - capital gain adjustment 765.00

4. There are two issues addressed in the Notice of Deficiency for the taxable year 1979. They are as follows:

4.a. Delta Selectune - disallowance of subchapter S loss $4,600.00

b. St. Louis Selectune - disallowance of subchapter S loss 825.00

5. Petitioners, on or before March 1, 1990, will amend their petition to claim that the statute of limitations on assessments had run before the Notice of Deficiency was mailed to petitioners. Such issue (called hereinafter the "Kelley issue") will be resolved in this case by this Court's decision as to whether it will apply the statute of limitations principle decided in Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989) as the law applicable to this captioned case which is appealable to the United States Court of Appeals for the Fifth Circuit.

6. The only issue remaining to be tried in this captioned case is the Kelley issue.

7. If this Court holds that the decision in Kelley v. Commissioner, 877 F.2d 756 (9th Cir 1989), does not state the law applicable in the Tax Court for purposes of this captioned case, then petitioners will owe deficiencies in tax for 1977, 1978 and 1979 of $8,560.16, $26,795.10 and $174.72, respectively, such amounts to be reduced by such payments as have previously been made. Petitioners will owe deficiencies in additions to tax under the provisions of I.R.C. § 6653(a) for 1977 and 1978 in the amounts of $428.00 and $1,339.75, respectively. Such deficiencies in tax are based upon the resolving of the three issues hereinabove described in paragraphs 2 and 3 as follows:

a. Issue 2.a is resolved by respondent conceding $15,000.00 and petitioners conceding $44,000.00.

b. Issue 3.a is resolved by respondent conceding $15,750.00 and petitioners conceding $44,000.00

c. Petitioners concede issue 3.b.

d. Petitioners concede issues 4.a. and 4.b.

8. If this court holds that the decision in Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), states the law applicable in the Tax Court for purposes of this captioned case, then a Rule 155 computation will be required for 1977. There will be an overpayment for 1978 of $1,531.80. There will be no deficiency for 1979. Further, there are no deficiencies in additions to taxes under I.R.C. § 6653(a) owed by petitioners for 1977 or 1978. Further, there is an overpayment of income taxes for 1977 and 1978 of amounts already paid of an amount to be determined. This is based

upon the resolving of the three issues hereinabove in paragraphs 2, 3 and 4 as follows:

a. Issue 2.a., 3.a., 3.b., 4.a and 4.b. are resolved entirely in favor of petitioners.

The parties hereby agree to this STIPULATION OF SETTLEMENT.

/s/Robert White
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Counsel for Petitioners
T.C. Bar No. WR0603
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By: /s/ Janet R. Balboni
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APPENDIX F
United States Tax Court Stipulation of Facts

ORIGINAL

U.S. TAX COURT
FILED AT
HOUSTON
OCT 15 1990

UNITED STATES TAX COURT

MARTIN BRODY and	§	
JERRILYN BRODY,	§	
	§	
Petitioners,	§	
	§	**Docket No. 963-87**
V.	§	
	§	
COMMISSIONER OF	§	
INTERNAL REVENUE,	§	
	§	
Respondent.	§	

STIPULATION OF FACTS

The parties agree to this stipulation of facts pursuant to Tax Court Rule 91. All stipulated facts are conclusively established. All stipulated exhibits shall be considered authentic for all purposes. Either party may prove the facts and exhibits set out in and with this Stipulation by offering the stipulation into evidence.

1. Petitioners resided at Houston, Texas at the time they filed the petition. Petitioners were husband and wife on the dates that their 1977, 1978 and 1979 Forms 1040 were filed.

2. For taxable years 1977, 1978 and 1979, Petitioners filed forms 1040 "U.S. Individual Income Tax Return" on October 15, 1978, October 15, 1979 and October 15, 1980, respectively. True and complete copies of the returns are attached as Joint Exhibits 1-A, 2-B and 3-C.

3. Pursuant to the provisions of I.R.C. § 6501(c)(4), Respondent and Petitioners during June 1981 executed an agreement in writing (Form 872A) to extend the period for the assessment of tax against Petitioners for the year 1977 until the date 90 days after the notification by either party to the other of termination of the consent, or the issuance of a statutory notice of deficiency. Attached hereto as Joint Exhibit 4-D is a copy of said Agreement.

4. Pursuant to the provisions of I.R.C. § 6501(c)(4), Respondent and Petitioners during August and September 1982 executed an agreement in writing (Form 872A) to extend the period for the assessment of tax against Petitioners for the year 1978 until the date 90 days after the notification by either party to the other of the termination of the consent or the issuance of a statutory notice of deficiency. Attached hereto as Joint Exhibit 5-E is a copy of said agreement.

5. Pursuant to the provisions of I.R.C. § 6501(c)(4), Respondent and Petitioners on September 12 and 13, 1983 executed an agreement in writing (Form 872A) to extend the period for the assessment of tax against Petitioners for the year 1979 until the time 90 days after the notification by either party to the other of the termination of the consent or the issuance of a statutory notice of deficiency. Attached hereto as Joint Exhibit 6-F is a copy of said agreement.

6. No notifications respecting terminations of the Forms 872A described in paragraphs 3, 4 and 5 were ever sent by either party. On December 18, 1986, a statutory

notice of deficiency was sent to Petitioners at their last known address. A copy of said notice is attached hereto as Joint Exhibit 7-G.

7. Petitioners were shareholders in a duly electing and qualified subchapter S corporation called Delta Selectune, Inc. (hereinafter "Delta") during their tax years 1977, 1978 and 1979. Delta was involved in a recording activity called "Selectune."

8. The Petitioners were also shareholders in a duly electing and qualified subchapter S corporation called St. Louis Selectune, Inc. (hereinafter "St. Louis") during their tax years 1978 and 1979. St. Louis also was involved in a recording activity called "Selectune."

9. Respondent made adjustments in the December 18, 1986, statutory notice of deficiency, to items claimed by Petitioners from Delta's and St. Louis' subchapter S corporation returns as follows:

a. For the taxable year 1977, a Delta loss of $59,000.00 was disallowed;

b. For the taxable year 1978, a Delta loss of $765.00 was disallowed and a St. Louis loss of $59,000.00 was disallowed; and

c. For the taxable year 1979, a Delta loss of $46.00 was disallowed and a St. Louis loss of $825.00 was disallowed.

10. A Form 1120S "U.S. Small Business Corporation Income Tax Return" for the taxable year 1977 was filed by Delta on or about March 15, 1978.

11. A Form 1120S "U.S. Small Business Corporation Income Tax Return" for the taxable year 1978 was filed by Delta on or about March 15, 1979.

12. A Form 1120S "U.S. Small Business Corporation Income Tax Return" for the taxable year 1979 was filed by Delta on or about March 15, 1980.

13. Respondent and Delta did not enter into any agreements to extend the periods for the assessment of taxes with respect to Delta for its taxable years 1977, 1978 and 1979.

14. A Form 1120S "U.S. Small Business Corporation Income Tax Return" for the taxable year 1978 was filed by St. Louis on or about March 21, 1979.

15. A Form 1120S "U.S. Small Business Corporation Income Tax Return" for the taxable year 1979 was filed by St. Louis on or about March 15, 1980.

16. Respondent and St. Louis did not enter into any agreements to extend the period for the assessment of taxes with respect to St. Louis for its taxable years 1978 and 1979.

17. The December 18, 1986 statutory notice of deficiency (Joint Exhibit 7-G) was issued more than three years after Delta filed each of the Forms 1120S for 1977, 1978 and 1979.

18. The December 18, 1986 statutory notice of deficiency (Joint Exhibit 7-G) was issued more than three years after St. Louis filed each of the Forms 1120S for 1978 and 1979.

19. If this Court holds that the statute of limitations

principle decided in Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), does not state the law applicable in the Tax Court, then there will be deficiencies to be assessed in the amounts of $8,560.19, $26,795.10 and $174.72 for the taxable years 1977, 1978 and 1979, respectively. There will be an overpayment due to Petitioners, after consideration of advance payments made for the 1977 taxable year in the amount of $4,127.31. There will be tax to be paid due from Petitioners in the amount of $10,766.79 for the taxable year 1978, after consideration of advance payments made. There will be tax due to be paid by Petitioners in the amount of $174.72 for the taxable year 1979. The above does not take into account payments made by Petitioners against the stated deficiencies and overpayments as follows:

Date of Payment	Year Applied To	Amount
October 1, 1986	1977	$16,715.25
October 1, 1986	1978	19,282.73
August 30, 1982	1979	441.10

In addition, Petitioners will owe deficiencies in additions to tax under the provisions of I.R.C. § 6653(a) for the taxable years 1977 and 1978 in the amounts of $428.00 and $557.21, respectively.

20. If this Court holds that the statute of limitations principle decided in Kelley v. Commissioner, 877 F.2d 756 (9th Cir. 1989), states the law applicable in the Tax Court for purposes of this captioned case, then there will be overpayments in tax for 1977, 1978 and 1979 of $29,402.75, $35,586.64 and $441.10, respectively. Further, there will be no deficiencies in additions to taxes under I.R.C. § 6653(a) owed by Petitioners for 1977, 1978 or 1979.

ABRAHAM N.M. SHASHY, JR.

Chief Counsel
Internal Revenue Service

/s/Robert White
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Date: 10/11/90

APPENDIX G
United States Tax Court Second Stipulation of Facts

ORIGINAL

U.S. TAX COURT
FILED AT
HOUSTON
OCT 15 1990

UNITED STATES TAX COURT

MARTIN BRODY and JERRILYN BRODY,	§	
Petitioners,	§	
	§	Docket No. 963-87
V.	§	
COMMISSIONER OF INTERNAL REVENUE,	§	
Respondent.	§	

SECOND STIPULATION OF FACTS

The parties agree to this second stipulation of facts pursuant to Tax Court Rule 91. All stipulated facts are conclusively established. All stipulated exhibits shall be considered authentic for all purposes. Either party may prove the facts and exhibits set out in and with this Stipulation by offering the stipulation into evidence.

1. Petitioners owned 10% of the stock in Delta Selectune, Inc. (hereinafter "Delta") and 10% of the stock in St. Louis Selectune, Inc. (hereinafter "St. Louis"). The business affairs of Delta were conducted in Austin, Texas, and the business affairs of St. Louis were conducted in

Missouri. The businesses of Delta and St. Louis were to sell, in specified territories, cassette and eight-track audio tapes containing musical selections chosen by customers from compositions in the record library of Franklin Industries, Inc.

2. At the time Petitioners made their investments in Delta and St. Louis, they did not contemplate having any active participation in the affairs of the corporations; rather they purchased the stock solely as investments. During 1977, 1978 and 1979 Petitioners had no participation in the affairs of either corporation other than as passive investors. Petitioners did not know the names of the other shareholders or the names of the directors of the two corporations.

3. By about 1981 the businesses of Delta and St. Louis failed and their offices were closed.

4. In 1979 Petitioners had been advised by Delta's management that the IRS was auditing Delta's 1977 return. Petitioners do not know whether Respondent ever examined tax returns filed by Delta for 1978 and 1979 or by St. Louis for 1978 and 1979.

5. By printed form letters, during June of 1981, August of 1982, and in September of 1983, Petitioners were asked by the IRS to sign Forms 872A to extend the statutes of limitations with respect to their Forms 1040 for 1977, 1978 and 1979. Petitioners were never advised of the reason for the extensions, other than that there were problems concerning Delta and the St. Louis deductions in 1978 and 1979. In any event, Petitioners were never advised by the IRS of the precise nature or magnitude of the problems until late in 1986.

6. Pursuant to the provisions of I.R.C. §

Forms 1040, Respondent and Petitioners executed the Forms 872A. Such forms for 1977, 1978 and 1979 had the effect of indefinitely extending the period for assessment of tax against Petitioners for 1977, 1978 and 1979. The extensions were to terminate by their own terms only upon the issuance of a notice of deficiency or earlier if either party gave notification to the other party of a termination of the Form 872A.

7. Because of their pending divorce, and upon advice of their divorce counsel, in late September 1986 Petitioners terminated the Forms 872A for 1977, 1978 and 1979 that they had signed. The reason for the termination was to find out whether the IRS was claiming additional tax from Petitioners for those years, and if so, the amounts. This information was needed for purposes of the divorce settlement. Then, on December 18, 1986, a notice of deficiency for 1977, 1978 and 1979 was sent to Petitioners who thereafter timely filed a petition in this Court.

8. Petitioners had nothing to do with the preparation and filing of either the Delta or the St. Louis Forms 1120S for 1977, 1978 and 1979 returns.

9. After receiving the notice of deficiency on December 18, 1986, Petitioner Martin Brody tried to locate the former manager of Delta and St. Louis in order to locate corporate records. He was unable to find the manager or the records.

10. During the years 1977 through 1986 Petitioner Mr. Brody was engaged full time in the hotel management business in Houston, Texas. During such period Petitioner Mrs. Brody was a housewife and part-time travel agent.

ABRAHAM N.M. SHASHY, JR.

Chief Counsel
Internal Revenue Service

/s/Robert White
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(2)

No. 92-495

FILED
OCT 20 1992
OFFICE OF THE CLERK

In the Supreme Court of the United States

OCTOBER TERM, 1992

CHARLES T. GREEN AND
KAY E. GREEN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

KENNETH W. STARR
Solicitor General
Department of Justice
Washington, D.C. 20530
(202) 514-2217

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether, when a loss is erroneously reported on the return of a Subchapter S corporation, and that loss "passes through" to the return of certain shareholders (with whom an extension of the period of limitation has been duly executed), the loss may be disallowed on the shareholders' return *after* the limitations period for assessing tax against the corporation has expired.

In the Supreme Court of the United States

OCTOBER TERM, 1992

No. 92-495

CHARLES T. GREEN AND
KAY E. GREEN, ET AL., PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

Petitioners correctly note (Pet. 6) that this case presents the same question presented in *Bufferd* v. *Commissioner*, 952 F.2d 675 (2d Cir.), cert. granted, No. 91-7804 (June 22, 1992). Both in this case and in *Bufferd* the courts of appeals concluded, correctly in our view, that when a loss is erroneously reported on the return of a Subchapter S corporation, and that loss "passes through" to the return of an individual shareholder (with whom an extension of the period of limitation has been duly executed), the loss may be disallowed on the shareholder's return even *after* the limitations period for assessing tax against the corporation has expired (Pet. App. 7a-17a; 952 F.2d at 676-678). The same conclusion

was also reached by the Eleventh Circuit in *Fehlhaber* v. *Commissioner*, 954 F.2d 653 (1992).

The Court granted certiorari in *Bufferd* to resolve the conflict between that decision and the contrary holding of the Ninth Circuit in *Kelley* v. *Commissioner*, 877 F.2d 756 (1989). Argument in the *Bufferd* case is scheduled for November 30, 1992.

The petition in this case should be held pending the Court's decision in *Bufferd* v. *Commissioner*, No. 91-7804, and disposed of as appropriate in light of that decision.

Respectfully submitted.

KENNETH W. STARR
Solicitor General

OCTOBER 1992